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SUBJECT: Belgian Chemicals Industry Faces Challenges

Refs: (A) 04 STATE 57073 (B) Brussels 3964

¶1. (U) Summary. Belgium's chemical industry is one of the country's most important economic sectors, representing 16 percent of national GDP. Many American chemical companies maintain a significant presence in Belgium. The industry faces challenges as high demand draws investment to the developing world and Eastern Europe. Upcoming implementation of REACH, the EU chemical registration initiative, will also raise costs. The Belgian Federal and Flanders Regional governments have recognized the risks to this important sector and taken steps to improve the investment climate. However, the underlying problems of high taxes and an inflexible labor market are hard to tackle. End Summary.

A Position of Strength

¶2. (U) The chemical industry is a crucial part of Belgium's economy. With revenues of 48 billion euros in 2005, it accounted for 16 percent of Belgium's GDP. The sector employs over 93,000 people and is a key part of Belgium's international trade; 80 percent of Belgian chemical products are exported, representing 31 percent of Belgium's total exports by value. The United States supplies 12 percent of Belgium's chemical inputs and receives 4 percent of its chemical exports. Inputs are processed and distributed throughout Europe from Belgium's chemical hub in Antwerp. The port of Antwerp is the second largest petrochemical agglomeration in the world, exceeded only by Houston, Texas.

¶3. (U) About half of all private sector investment in Belgium is in the chemical industry. The sector is also one of Belgium's main attractors of foreign investment; in 2004, 75 percent of total investment in the chemical industry came from outside of Belgium. The United States is well represented in the Belgian chemical sector; American companies held an estimated 5.3 billion dollars of capital stock in the industry in 2004. Du Pont, Chevron Phillips, Dow, ExxonMobil, Shell, and others all have a strong presence in Belgium.

¶4. (U) Despite its importance to the Belgian economy, the chemical industry faces several challenges to its future growth and development. The chemical industry shares the malaise affecting much of Belgian industry: an investment climate of high wages, high taxes and low labor flexibility. Due to growing demand for chemical products in the developing world and highly competitive production costs there, multinational corporations are focusing attention and new investment dollars on Turkey, Russia, China and the Middle East rather than in Europe. Lower wages and higher fiscal incentives in the new EU member states make them increasingly attractive venues for European operations and headquarters, challenging Belgium's traditional role as "the capital of Europe." Rising energy costs are also taking their toll on the industry. Because many processing methods are quite energy-intensive, even a small increase in energy prices can drive a firm's costs up considerably.

¶5. (U) Following a period of loss and stagnation in 2003 and 2004, the Belgian chemical industry saw a return to revenue growth in ¶2005. Industry experts predict this trend will continue through 2006-2007. However, this revenue growth reflects mostly an increase in prices rather than productivity; while revenues increased 4.3 percent in 2005, output and material investment in the same year were both lower than 2004 levels, by 3.6 percent and 10.5 percent respectively. Investment levels are expected to rebound in 2006 as several new investment projects have been announced, including the construction of a new, cleaner-burning electric plant at ExxonMobil's Antwerp refinery. ExxonMobil is also planning to expand its existing petroleum refining capacity by 10-15 percent over the next three years. Employment in the industry has been relatively stable over the last five years.

¶6. (U) Pharmaceuticals are a subsector within Belgium's chemical industry that has attracted high levels of American investment and accounted for much of the chemical industry's annual 8 percent increase in research and development over recent years, twice the industry's average. Basic chemicals and plastics have also enjoyed steady growth. Textile chemistry, on the other hand, has experienced negative growth for much of the last five years, following the shift in textile production to China and other industrializing developing countries.

The Challenge of REACH

¶7. (U) The industry must also prepare for the coming implementation of REACH (ref A), the new EU regulatory framework for the chemicals sector. Chemical companies have already begun preparing for REACH, taking inventories of their products and factor inputs to gather what data they already have on the chemicals likely to be registered.

¶8. (SBU) Costs of implementing REACH, while difficult to calculate, are expected to be substantial. DuPont Belgium alone will need to register 120 different substances at a cost of 20,000 to 500,000 euros each, depending on the tonnage used. Added to the registration costs will be the cost of labor and management time expended on the process, the fee to be paid to the new European Chemical Agency, and the long-term costs of developing adequate substitutes if the agency should so require. The real costs will depend on the speed of processing and strictness of enforcement by the European Chemical Agency, but most analysts expect the competitiveness of Europe's chemicals industry to be negatively impacted.

¶9. (SBU) The costs of REACH are expected to fall hardest on small and medium enterprises (SMEs) that produce finished articles and thus have more links in their supply chains. Most American chemical companies operating in Belgium are large multinationals and do not fall into this category. The risk for American companies operating in Europe is that small Belgian companies could go out of business and stop supplying key chemicals to their downstream users, who would then have scramble for alternate chemicals or suppliers. The risk of such an avalanche occurring is quite high, since SMEs make up the majority of the Belgian chemical sector; half of all Belgian chemical firms have fewer than 50 employees. Some of the larger American companies in Belgium have indicated that they would consider partially or even wholly subsidizing REACH registration for suppliers of key inputs in order to prevent disruption of their supply chains.

¶10. (U) A different risk comes from the higher costs of chemicals sold in Europe, as REACH administration expenses are passed along to customers. If finished article manufacturers opt to cease production in Europe due to higher factor input costs, they could weaken demand for the products they had been purchasing from other suppliers. This ripple effect in the Flanders region, where chemicals play a particularly dominant role in the economy, would impact the national economy rapidly.

DISINVESTMENT RISK

¶11. (SBU) Belgian authorities are particularly concerned about the

impact that disinvestment and relocation of chemical producers out of Belgium would have on the national economy. The industry is a crucial component that feeds the national logistics and manufacturing sectors. When Belgian chemicals and plastics giant Solvay recently announced major investments in China to produce products for use in Asia, including specialty chemicals plants it intends to construct in Korea and China in 2007, Flemish political leaders asked for reassurances from the national champion that the action did not portend future relocation of processing. Recently the Vice-President of Total, the Belgian-French based petrochemical company, stated publicly that Belgium faced a triple challenge: low industrial growth, high energy costs, and globalization's wage cost competition. Half of Total's investments today are in Asia, he said, where Total expects to make 20 percent of its sales by 2010.

¶12. (SBU) Although the impact of companies moving their operations out of Belgium would be major, its risk in the near-term appears small. Industry analysts expect relative stability for the first five years under REACH. The plants currently existing in Belgium are there first and foremost to meet demand on the European market, which will still exist after REACH goes into effect and cannot be as effectively served from other parts of the world. It is possible that facilities for a few specific products may be moved to Asia or the U.S., but transport costs for large volume goods make such a move unrealistic for many products. Most companies say they will wait until the registration regime has been in operation for a few years and the effects of the program can be more reliably calculated before making drastic changes to their stock of capital investment abroad.

TAX INCENTIVES

¶13. (U) Trying to preempt chemical and other industry relocation out of Belgium, the GOB has introduced some fiscal incentives to reward capital investment and reduce labor costs. (See ref B on the notional interest deduction and a forthcoming cable on the 2007 budget for further details.) For internally financed companies, such as many major chemical concerns, the notional interest deduction is a significant incentive, lowering average corporate taxes by 7 percent by one law firm's estimate. Several chemical companies have taken advantage of the program since it came into force in January 2006.

¶14. (U) Belgium is also taking steps to encourage research and development. Since 2003 many researchers in the public sector have been eligible for a 50 percent exemption from advance payment of wages, lowering research wage costs by 15 percent. This initiative has been experimentally made available to some private sector researchers in 2006. Belgium has also instituted an R&D tax deduction, set for tax year 2007 at 14.5 percent for a lump-sum deduction and 21.6 percent for a staggered one. An additional tax credit for research-related investment will come into effect in ¶2007. These measures could have significant positive benefits for the chemical industry, especially in subsectors like pharmaceuticals and eco-friendly technologies that have a large R&D component.

FLANDERS FOCUS

¶15. (U) The Flemish regional government released a report in summer 2006 recommending steps to improve conditions for the chemical industry in Flanders. In addition to bemoaning labor costs, the report suggested some non-fiscal measures that could be improve the investment climate for the chemical sector. According to the report, enhancing intellectual property protection and founding strategic research centers in Belgium would encourage innovation and prevent brain drain. Improved rail, road and pipeline infrastructure would magnify Belgium's connectivity between production and distribution centers, already one of the country's strong competitive advantages for the chemical industry. The report also recommended strengthening links with educational institutions to ensure a larger, more capable employment pool for the future of the industry.

COMMENT

¶16. (SBU) While the Flemish report made a number of recommendations, it focused on areas under the control of the Flemish regional government. Competitiveness of the Belgian chemical industry, and the health of U.S. companies interdependent with it, hinges far more on cost and flexibility of the labor market than on education or transportation. The federal coalition government has been reluctant to tackle these issues head on because they strike at the core of Belgium's "social model". Bold change is unlikely unless Belgians start to feel a more widespread economic pinch from industry contraction in response to better conditions elsewhere outside Belgium.

Korologos